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Q1 FY2016 Earnings Call Transcript – August 03, 2015

CORPORATE PARTICIPANTS:

- Mr. Rajesh Subramaniam – Managing Director and Chief Executive Officer
- Mr. Dinesh Jain – CFO
- Mr. Ganesh Iyer – Head Strategy & Investor Relations

Moderator: Ladies and Gentlemen, Good Day and Welcome to Firstsource Solutions Limited Q1FY16 Earnings Conference Call. As a reminder, all participant' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ganesh Iyer from Firstsource. Thank you and over to you Mr. Iyer.

Ganesh Iyer: Welcome, everyone and thank you for joining us for the Q1 FY16 Earnings Call for Firstsource. Please note that the Results, Fact Sheet, and the Presentation have been emailed to you and you can also view this on our web site www.firstsource.com. To take us through the Results and to answer Questions we have with us today Mr. Rajesh Subramaniam — our MD and CEO and Mr. Dinesh Jain — our CFO. We will be starting this call with a Brief Presentation providing an Overview of the Company's Performance followed by Q&A Session.

I would like to remind you that everything that is said on this call that reflects any outlook for the future or which can be constituted as a forward-looking statement must be viewed in conjunctions with uncertainties and the risks that we face. These uncertainties and risks are included but not limited to what we have mentioned in our prospectus filed with SEBI and the subsequent annual reports that you can find on our web site.

With that said I would now turn over the call to Mr. Rajesh Subramaniam — our Managing Director and CEO.

Rajesh Subramaniam: Thank you, Ganesh. Good Evening to Everybody on the call. In terms of our Q1FY16 Performance Analysis, our operating revenues in Q1FY16 came in at Rs.746.9 crores compared to Rs.755.6 crores in Q1FY15 and Rs.754 crores in Q4FY15. The quarter-on-quarter degrowth was 0.9% in rupee terms and 2% in constant currency terms. The Year-on-Year degrowth was 1.1% in INR terms and degrowth of 4.57% in constant currency terms. From an operating EBIT perspective, Q1FY16 the EBIT was Rs.72.5 crores compared to Rs.75.5 crores in the same period last year and Rs.81.3 crores in Q4FY14. Quarter-on-quarter degrowth of 10.9% representing a margin reduction of 110 basis points from 10.8% to 9.7%. Year-on-year degrowth of 4.1%, margin reduction by 30 basis points from 10% to 9.7%. At PAT level, our PAT came in for Q1FY16 at Rs.56.4 crores compared to Rs.53.2 crores in Q1FY15 and Rs.62.3 crores in Q4FY15. Quarter-on-quarter degrowth of 9.5%, margin reduction of 70 basis points from 8.3% to 7.6%, year-on-year growth of 6%, margin expansion by 60 basis points from 7% to 7.6%.

Just to set the context of what happened in Q1FY16: We shut down 2 centers in the Domestic business where the impact of the revenues was close to Rs.4 crores. The shut down some of it was planned in the previous quarter, but the impact on revenues and also on profitability was a little out of line. There were certain shut down costs and severance costs driven by regulation in the states where we shut them down which ensured that Rs.4 crores reduction in revenue

cost us almost Rs.3.3 crores in EBIT. This does not recur in Q2. This is one-time and the profitability of the business unit in Q2 is clear and present. Similarly, the Telco deal that we have signed up which we had represented that we were having some operational challenges, the operational challenges continue largely on the back of significantly high attrition which is necessitating us to maintain a higher bench to deal with a certain given level of volumes which are not scaling because of some of the supply chain issues. Also, some of the marketing programs which were targeted by the client have been delayed which also results in softness of volumes and that impact has almost been Rs.12.5 crores in the quarter from what we expected it to be translating into a bottom line reduction of almost Rs.4.9 crores. These are the two big events which dampened our Q1FY16 performance but as we go through the presentation I will touch upon or highlight on why we believe some of the guidance that we had given both on revenue and in profit will play themselves out.

If I turn you to the next Slide #5, cash and cash equivalents of Rs.194.6 crores compared to Rs.147.8 crores in the previous quarter, we repaid $11.25 million on June 30th 2015 and our CAPEX spend in Q1FY16 was Rs.17.8 crores. Outstanding debt we refinanced at a very attractive interest rate. We also converted some of our realized short-term debt into long-term debt at these attractive rates and we also augmented our cash position. Our long-term net debt is $112.2 million as on June 30th 2015. As I mentioned USD 30 million short term borrowings have been converted to long-term and we have augmented our cash given some of the deal pursuits we are undertaking. One of them is a large left out to pay deal which will require us to put out $10 million and this contract potentially is £110 million contract over 9-to-10-years which at this point in time I cannot disclose anything more as we are in the final stages of contract negotiation. Given it is to pay deal, the revenue recognition would be as soon as the announcements are made and the shortfalls that we see in the Telco deal which is facing its current challenges that I had articulated upon is made good in the second part of the year… a good part of the short fall is made good in the second half of the year. Once we bring this deal home in its entirety, I will have more clarity in disclosing the details to the constituents on this call.

From a FX hedges perspective, our current FX hedges are at $37 million and £57 million, next 12 months 90% coverage for the USD at Rs.67.5 and 89% coverage for GBP at Rs. 111.5 and the Philippine Peso, 21% coverage for GBP at PHP 69.9. For the forward 12 to 24-months 50% of our USD coverage at Rs. 70.3 and 69% coverage for the GBP at Rs. 111.4 and no coverage taken for the peso to the pound.

On statistics relating to the employee seat and seat fill: 23,939 employees as on June 30th 2015, seat capacity of 22,984 seats, 46 delivery centers as on June 30th 2015. We shut down 2 centers and we added 1 international center as compared to Q4 last year. 14,607 employees in India and 9332 outside of India. We reduced 1346 employees in Q1 FY15, of which 1328 employees were in the Domestic business. Seat fill factor at 68.4% compared to 68.5% in

Q4FY15 and we will see an uptick in the ensuing quarters as the built-out capacity gets filled on and the shutdown capacity starts reflecting in a denominator.

Improvement in the attrition in the offshore estate; 50.3% compared to 52.7%, a little bit of a spike in US and Europe largely in US in the program in Louisville I spoke to you about 46.4% compared to 40% and India largely in the same relations, slightly higher on account of the shutdown of the two centers that I spoke to you about.

From a summary of how we derive our revenues, if you see, North America continues to be the largest growth engine, contributing 56.3%, UK contributing 34.7% and India dropping by 130 basis points from 10.3% to 9%. From a vertical perspective some of the bets we are taking in Healthcare are clearly paying off. So from 34.7% contribution in Q1FY15 Healthcare contributes almost 40% representing the largest vertical… it was the largest vertical in Q4 but in a way it clearly the growth rate you are seeing in that business and the quality of earnings we are seeing in that business clearly is auguring well for the company. Similarly, our Telecom and Media 37.5% to 36.5% between Q4FY15 and Q1FY16 and if I take a look at it from the previous year's quarter to now a combination of the Irish Telco and the Domestic business ramp down is reflecting in why it has come down from 43.8% to 36.5%. BFSI 24.3% to 23.9%, again this is some rebalancing of the portfolio in some of the Banking work we are doing offshore and some tail end effects of seasonality in our Collections business. From a customer concentration perspective, our top client 22.2% to 20.8%, two factors – one, obviously, there is a growth in our other clients but also there has been some volume softening in estate redesign by our top client which we expect will correct itself in the ensuing quarters based on the forecast and the projections which have been given. This will come back up. Revenue from delivery location: Onshore it is 70.5%, Offshore at 21.9% and Domestic at 7.6%.

Going forward looking at the tabular representation of our results, just a couple of call outs; one, SG&A expenses in Q1FY16 have been higher, significant additions to the end-market solutions, sales, marketing and new product development teams in the US and UK where we have the investments will start playing themselves out in the ensuing years, and the other call out would be on the tax rates which have obviously stepped up in Q4FY15 based on some of the profits from the SEZ going into a different slab and some of the incremental profits we see in our onshore business against which some of the shields are not as much as they have been in the past. While there has been a margin deterioration of 30 basis points between Q1 of last year and Q1 of this year at the EBITDA level, this will bounce back in the ensuing quarters and the translation of the 100 to 120 basis points guidance we had given at a net level, will be met as we approach the end of the year.

From a business outlook perspective, the demand environment continues to be very attractive. Some of the deals we have won which will ensure a significant uptick from Q2FY16 onwards and more full blown in Q3FY16 are transformational deals. There are deals around end-to-end

service offerings in Healthcare, there are deals around new service line in our BFSI segment. The pipeline across both Healthcare and Customer Management look very attractive. As I had mentioned, although a flattish Q1, growth will be evident from Q2 and we continue to maintain 7% to 8% growth for the year with some risk led by the Domestic business which continues to go through some periods of stress especially our Telco clients given some of the market changes which are happening. We are confident that despite the setbacks in our Telco business in the US which will be made up through the left out deal that will play itself out in the latter part of Q2 and full blown in Q3 and Q4.

Healthcare, BFSI UK, T&M US will be the leading growth contributors for the year. Domestic business, as I mentioned, seeing a downward trend. Collections too remain flattish but obviously it will have an improved margin profile. As I had mentioned, on the profit level 100 to 120 basis points on this growth rate is something we do have visibility of and will be evident from Q3FY16. We would still have some of the stress on the Telco ramp continuing in Q2FY16. From Q3FY16 onwards with the full blown left out deals which represent into revenues and the ramp of our Web Chat work for the same Telco in another location which is doing extremely well right now will start reflecting in the margins. No call out on the long-term debt. Just as I mentioned it is a similar repayment plan. We continue to pay $11.25 million per quarter going forward and despite the margin reduction in Q1FY16 the margin profile of 100 to 120 basis points for the full year is the guidance I have for all of you. That is it from me. I will hand it back to the moderator to open the floor for Questions.

Moderator: Thank you very much. We will now begin the Question-and-Answer Session. The first question is from the line of Srivathsan from Spark Capital. Please go ahead.

Srivathsan: Srivathsan here. Rajesh, just wanted your comments on the top line. Even though it was an anticipated decline in revenues, with the newer approach that is fitting to the top line, do you think we could claw back on the margins front in the top line?

Rajesh Subramaniam: On the top line, just one data point; the Telco client is going to set me back by about anywhere between $12 million to $15 million this year. What is going to happen is the cost of growth for the full blown numbers we are looking at obviously will stand reduced, there is no cost of growth because from day one I bill the entire ACV and it comes at a reasonably good margin profile. That is one. One more element I did not mention was Q1FY16 also reflects investments we made with a very large consulting outfit and some of the work that we have been doing over the last 6-months in terms of delayering, in terms of driving better levels of efficiency and of the cost takeout there is a clear path of how we are going to generate an additional Rs.15 crores to Rs.17 crores in profit which going is to act as a buffer for some of the first half profits that we see fall off. Obviously, some element of that will start reflecting in Q2FY16; people serve out 3-month notice, some severance, but in the second half, those numbers will start clearly demonstrating results. What I do not have control of right now at this point in time our Domestic business from last year is trending at $4 to $5 million

reduction and my sense is we might end the year at an $8 million reduction which roughly translates into 1.2% to 1.3% degrowth at a company level. That is the only thing which can play some pressure on our 7% growth rate, but the good thing about the Domestic business any shut down there ultimately with 3 to 6-months effect has an accretive impact on the profitability which will be evident in Q2FY16 for the actions which we took and actions which even some of the clients decided to enforce when we came up for some contract renewals and we agreed that some of the indexation-related ask we had were not acceptable to them. On a profitability perspective, definitely, Q2FY16 sequentially will be definitely stronger; year-on-year there will be growth but not to the extent that we would have liked assuming that the Telco clients had stabilized for all the work we had done last year, but Q3FY16 onwards the entire to-pay deal and the project impact which is the cost saving initiative that we have been driving over the last 3-4 months which would have been addition to what we would have had if we did not have the stabilization issues with the US Telco will start showing up in the margins.

At this point in time, we are absolutely confident that to grow the 100 to 120 basis points is definitely tenable despite a higher tax regime. The higher tax regime takes out some of the benefits we got from the interest cost reduction… because of reduction in the payment of debt and refinancing the debt from effective 6% to 4% this year. Despite some of the incremental tax eating into the interest cost savings this year, we are confident of hitting those numbers.

Srivathsan: It is 100 to 120 bps, not operating profit?

Rajesh Subramaniam: Operating profit would be somewhere between 70 to 90 basis points.

Srivathsan: Overall, the amount of ramp-downs or weakness you are seeing in the Customer Care portfolio, just wanted to get your thoughts in terms of your approach to that specific end-market, do you think there is an urgent need to kind of diversify out of customer care as a category and reduce it possibly even to less than one-fourth of revenues, if we had to not look at this quarter, we just step back and look at over the last 3-years, the amount of negative surprises we have had and possibly a very-very few positive surprises, on a 2-3-year perspective, is this something that causing you a lot of concern?

Rajesh Subramaniam: I will tell you what is happening, Srivathsan. The whole Customer Care business, the rapid change in how Customer Care evolves into a larger digital play, larger deflection, and automation play is not evident as per what the pundits are defining. What is happening… and I will be very candid here, there is a lot of weight and switch which is happening as large deals get renegotiated in basis on what the expectations of the customers, what has been promised, and what actually results. So some of the deals that we had lost in the past, a couple of them today with whoever has won it, is in arbitration because of the expectations of what was promised and what is actually being delivered. So it is not easy. At least from our perspective, what we are doing in terms of creating a center of excellence around Web Chat.

Today, my largest client equivalent in the US, we were 4 among 16 partners that they chose and they will start small with us at about 100 to 200 FTEs in Q4 but ramping up to 800 to 1000 FTEs in next year. That is the scale… these guys outsource about 20000 FTEs and they have a huge demand in their universe. What we are doing is we are sticking to our strengths. We are building centers of excellence around Web Chat and around FCI which is predicting customer journeys and creating deflection strategies which are realistic and not predicated on future outcomes, predicting customer behavior which is completely an unknown. At least from where we see, this is a scalable business and this is a business which can generate solid profitability but there is some pain in the whole transformation journey between clients' expectations and the realities of how this will play out. Next 2 to 3-years there will be a shrinkage… this business will not grow at 15-20% that we are seeing in the Healthcare business but this business definitely can grow at 10% and generate a decent level of profitability but it will be bumpy because in this business cost of growth hits us. Q2FY16 why I am cautious about the margin expansion is because of the significant cost of growth that is going to hit us on some of the new wins we have had in the Healthcare segment and all that translates into full blown revenues and profits in Q3 & Q4. As I said, this business is a good place to be in, in terms of what we are selling as long as client expectations are realistic which also reflects in some of the volume softness that we saw in offshore in Q1 which are getting rebalanced in Q2 and Q3.

Srivathsan: My last question is on the takeout deal that you are talking of. You said about $10 million upfront fee and about £110 million of TCV over 8-9-year. Are my numbers correct?

Rajesh Subramaniam: It is a $10 million payout representing £100 million to £110 million over 9 to 10-years.

Srivathsan: Do you think the profitability of this deal can be higher than company average margins because otherwise it seems to be an NPV-dilutive deal?

Rajesh Subramaniam: After amortization of the upfront, this is an accretive deal.

Moderator: Thank you. The next question is from the line of Priya Rohira from Axis Capital. Please go ahead.

Priya Rohira: Just wanted to understand in terms of the deal pipeline. Last quarter we exited at around $495 million odd which was up around $80 million. Just wanted this quarter how has it shaped? Secondly, you mentioned on a telecom client there was some pressure because of postponement of marketing plan. Do we see this contributing from the second quarter in terms of revenues? Lastly, in terms of the salary hikes, what has been the impact?

Rajesh Subramaniam: On the first question, the deal pipeline has largely remained flat; we had $495 million in Q4, we are roughly $501 million, we won about $24 million but net of some of the scope changes and some of pricing related and what has happened with our US Telco, the net realization would be only $5 to $7 million going forward, but the quality of the pipeline definitely looks

good, and as and when the deal conversions of the large deals that we are talking about start looking in and the new sales force which is at various stages of joining the company starts playing themselves on I am confident that the pipeline will look better. On your second question, the Telecom deal about $13 million to $15 million of revenues which were expected will get delayed into next year. It is not going to reflect from Q2FY16 onwards. There is pain in Q2, there will be some pain which will continue in Q3. Some of this will flow into next year but the shortfall in what this client represents will be made good by the left out deal which I alluded to. There is some pain and unfortunately pain that we are seeing on the revenue is also translating into pain in the margins, but we have initiatives to ensure that it does not knock the margin profile of the impact that it would have directly had but for all the cost saving initiatives that we have undertaken. On your third question on wage hikes, the wage hikes will have an impact of about 2% to 2.5% on our entire portfolio, but we have enough operating leverages to mitigate that some of the FX hedge gain that we have year-on-year and some of the efficiencies in terms of improving the work hours-to-paid hours ratio in several parts of our business whereby the net addition of people I would need to generate certain level of revenues will not be in the same proportion as it has been last year. So, some of these levers actually will help me absorb the wage hikes that we are effecting.

Priya Rohira: On the Healthcare, we have been very upbeat. How you are seeing that growth? You mentioned around 16-17%. Do you see any change over there or do you think the pipeline will only turn better given the new recruits which are happening…?

Rajesh Subramaniam: Absolutely, our current estimates suggest 18% to 20% growth year-on-year, both the Payer and Provider segment as a business, last year the Healthcare business was roughly about $160 million, and this year we are anywhere close to about $180 to $185 million is the trajectory with some upside.

Priya Rohira: That is done better compared to what we had anticipated?

Rajesh Subramaniam: That is right. That is what, **s**ome of the investments we made in NPV, some of the alliances we have forged and some of the capabilities we have built in cross selling our Customer Management work into the Healthcare Payers, they are all paying off and we are seeing some very rapid movements in that part of the world which is reflecting in how that vertical which was 33% last year is closer to 40% of my revenue this year.

Priya Rohira: You mentioned that Q2FY16 margins will get impacted because you are cautious on the new deals commencing which could have some impact on the margins. Just wanted to understand that bit a little bit more, is there any transition cost which we will have to bear or more in terms of lower utilization during that time?

Rajesh Subramaniam: It is cost of growth in supporting the ramp and some of the transition cost. Sequentially, there will be a clear expansion of my profitability including margin expansion, but not to the extent

which will give you the comfort on how I am going to get to a 120 basis points expansion based just on my Q2 numbers, but by keeping to watch out on my Q2 numbers will be my top line growth which will be real.

Moderator: Thank you. The next question is from the line of Sanjeev Hota from Sharekhan. Please go ahead.

Sanjeev Hota: Rajesh, last quarter you mentioned about loss of Rs.4 - 5 crores revenue in Domestic market owing to the pricing renegotiations. So, that issue is over and now this quarter you are talking about this Rs.4-5 crores loss because of the shutdown plant in last quarter. So, if you could clear it as I am not getting that point?

Rajesh Subramaniam: Q4FY15, we planned to shut down the centers, but the revenue impact of those shut downs were more than what we had estimated. Coupled with that the shutdown cost, usually when we shut down, this is not the first time we are shutting down Domestic business, the impact of the margins is to run the people of based on the attrition profile and minimize the shut down costs but this time shutting down entire centers, one is in Hubli and the other one in Patna has resulted in certain breakage cost which have costed me the cost of shut down at Rs.3.3 crores on the bottom line.

Sanjeev Hota: Going forward into the next quarter, we are talking about the EBITDA margin; there will be some pain also because of the cost of growth in the Healthcare?

Rajesh Subramaniam: No, the absolute EBITDA will increase, but all I am saying is despite the pain, the absolute EBITDA will increase both sequentially and on a year-on-year basis, but the pace of growth has cost of growth which then sets me up for the overall year-end margin expansion which I have committed to which will reflect on Q3 & Q4.

Sanjeev Hota: And for year-on-year margins do you still expect the EBITDA margin of 100-250 basis points or net…

Rajesh Subramaniam: EBITDA margins were 70 to 90 basis points at the operating EBIT level and 100 to 120 basis points at the net level.

Sanjeev Hota: So you have changed the thing, because last quarter you were talking about 100-150 basis points on the EBITDA side?

Rajesh Subramaniam: Correct, because of what has happened in my largest Telco in the US where as I had explained we have lost revenues and about Rs.4.5 crores in profitability, the revenues will be made good by the left out deal which I spoke to you about, but there will be some pressure on the margin side. The margins which I would have ideally got for four quarters from the US Telco now is made up by revenues in the latter part of Q2 and full blown Q3 and Q4, but does not give me

the ability of ploughing back the entire profitability which has impacted in Q1 and some of the pain continues in Q2.

Sanjeev Hota: Other income of Rs.4.5 crores, is there any one-off this quarter?

Dinesh Jain: No, May be Rs.1 crore is a one off which is currency translation, otherwise the balance is on surplus cash we have from our investments.

Sanjeev Hota: What about the tax rate we can take for FY16-17?

Dinesh Jain: This is 2016 we should be between 10 and 12%; I think 2017 should go by around 14% and 16%.

Sanjeev Hota: Is there any changes in the depreciation because there is a huge like from the last quarter once Rs.17.9 crores hit, this quarter Rs.17.2 crores, so what kind of run rate we can take on the depreciation?

Dinesh Jain: Depreciation… I think the reduction is on account of the center which we have closed down. So depreciation is not required to charge, but as we are doing investment and you must have heard that we put in around Rs.18 crores I believe the depreciation trajectory should be around between Rs.18 to 19 crores a quarter, year-end we will probably end with Rs.80 crores.

Sanjeev Hota: What kind of CAPEX do you see for FY16?

Dinesh Jain: CAPEX is still going to remain between $10 million to $12 million, we are expecting another $6 million to $7 million further to invest depends on when the growth is going to come and whether it is come on my existing facility or other same places we may have to set up a new center, we expect it to be between $10 to 12 million.

Rajesh Subramaniam: Roughly 50% of that is in the operating model and 50% would be with the cash from our balance sheet.

Sanjeev Hota: You talk about this quality of ACV deals is improving. So, what do you mean by quality … are we seeing the better margin profile coming in this incremental deal that is going to come?

Rajesh Subramaniam: Better margin profile will be based on theories of transformation embedding both automation and effective work flow management is in a new line of work which is more back office processing which has a higher level of stickiness from driving productivity from the baseline that we inherit.

Moderator: Thank you. The next question is from the line of Dipesh Mehta from SBI CAP Securities. Please go ahead.

Dipesh Mehta: Two questions: First about just to get some sense about top clients. I think it is expected to come for renegotiation. I think you made some comment, but I am not yet clear about how we see top line performing for us and what was the outcome for renegotiation?

Rajesh Subramaniam: The top client is there are certain estate redesign between their multiple captive centers and the two outsource partners that they have. Some of that we have seen some softness in Q1 but latter part of Q2 and Q3 is seasonally their higher demand quarters and currently, we are on the ramp up both onshore and offshore with them. The contract negotiations will play themselves out by September. The good thing is the entire methodology and the basis have been agreed on and this contract as of now between the two partners they engage with will get renewed. The expectation is before the end of September.

Dipesh Mehta: Second question is about US Telco clients what we are referring to in terms of one of the pain points. Can you help me understand because when we sign, I think it is for some specific period? So whether we will actually see less revenue than what we earlier anticipated from their client and how we intend to make up for that revenue?

Rajesh Subramaniam: Revenue shortfall would be $13 million to $15 million from what we anticipated from this client. Two lines of work — one was the Customer Care and the other one is for Web Chat in 2 different locations. The Web Chat work is ramping up beautifully, attrition rates are low and our expertise in Web Chat are obviously ensuring that we are among the two-two, three partners for them in their line of work and that business can scale in the future. On the customer care work, there is a lot of pain in the whole supply chain management and also there is volume softness. Our peak attrition rates were almost 30% a month which is now closer to about 18-20%. So, to deal with the volumes which would ensure that I did not lose $15 million, I would need 40% more staff which unfortunately because of the way the program is structured in terms of very high occupancy rate leading to very high burnout, coupled with the fact that in the location we have a few captives which are obviously paying a lot more and the state in which we operate has got lower unemployment rates compared to rest of the United States. So, multiple issues. So in this business the prognosis is that I need to cap out at the current volume at least for the next 6-months and improve the work cost to pay it us, reduce the shrinkage and manage the attritions which are now trending at closer to 12-15% from the earlier numbers I discussed which will see a revenue shortfall this year and that revenue is not lost, that revenue will have a catch-up next year and the ability for me to make money on those revenues will only happen if some of my three floor management and input measures are managed. So, at the current level, if I claw back that $15 million, we lost Rs.4.4 crores in Q1FY16, the loss could end up anywhere closer to about $3-3.5 million which we do not want to. So, at this point in time, we are engaging with the customer to scale the Web Chat work, platen out the customer care work for the next six months and catch up on the customer care work over next year. In the meanwhile, some of the fixed cost investments which have been made in the center, we are looking to put in our healthcare customers whom operate in the same building but on processing work to ensure that the center can reach to profitability

based on the mix of business between multiple clients. The reduction in revenues which I spoke about, majority of that will be clawed back by the left out deal which will represent in latter part of Q2, painful blown in Q3 and Q4.

Dipesh Mehta: The takeout deal what we are referring to, that deal has already been signed or it is likely to be signed in this quarter?

Rajesh Subramaniam: Likely to be signed, the contract negotiations are ongoing.

Dipesh Mehta: Just about this Telco, this $13-15 million what we refer, that is what we are expected to miss in FY16 compared to our earlier estimate, that is right understanding?

Rajesh Subramaniam: Yes, $13-15 million would have been the revenues we are going to be not delivering against this contract which will flow into next year once the current business stabilizes at the volumes I am in right now.

Dipesh Mehta: My question is earlier we anticipated cumulative TCV kind of things from that business. Whether it will go down because now we are differing in terms of period but tenure would remain the same?

Rajesh Subramaniam: No, tenure is 2 plus 1 year.

Dipesh Mehta: Now, already 1-year would be away, right?

Rajesh Subramaniam: This started in October last year, so yes, you are right; 1-year would be over in October this year with another 2-years.

Dipesh Mehta: You expect it to make up in next 2-years?

Rajesh Subramaniam: Yes, next year it will come back to the ACV which we should have delivered this year.

Moderator: Thank you. The next question is from the line of Mohit Jain from Anand Rathi. Please go ahead.

Mohit Jain: Rajesh, two things; One, your guidance includes the left out deal, right? If that does not happen for whatever reason, we should reduce the revenue outlook accordingly?

Rajesh Subramaniam: That is right; this includes the left out deal which as I said will translate into clawing back a significant portion of the $13-$15 million reduction in my US Telco.

Mohit Jain: That will be accrued for 6-months, right?

Rajesh Subramaniam: That is right.

Mohit Jain: Second, your gross margin looks higher for this particular quarter even excluding the SG&A. So, any other cost pressures which you have faced in this particular quarter? Should we remove that Rs.3.3 crores impact that you referred?

Rajesh Subramaniam: Some payouts which are driven by Shop and Establishment and some labor commissioner related, something peculiar which we have not earlier faced in our shutdowns that we have seen and more linked to the fact that this was a complete shutdown of the center, some of the earlier ramp-downs that we have done in the domestic were part of an existing set up where it was not leading to a complete shutdown but letting go off people based on lines of business within the clients which were not working. This was actual centers which were shutdown lock, stock and barrel which resulted in the Rs.3.3 crores loss.

Mohit Jain: This Rs.3.3 crores is the one-time cost which is included in your P&L expense?

Rajesh Subramaniam: That is right.

Mohit Jain: This left out deal, is it with an existing client or is it a completely new client?

Rajesh Subramaniam: I cannot discuss anything, very strict confidential norms at this point in time. Once the deal is signed, we will definitely have a longer chat.

Mohit Jain: On your topline, this has come up multiple times. But the slowdown you mentioned is purely because of postponement of marketing plans and some redesigns?

Rajesh Subramaniam: No, one is as I said, there is a supply chain issue which is also a god send that if they had launched their new product and the new plan, I would have been in deeper trouble. So, what is happening is based on the current volumes that we are handling, we are at this point in time struggling for the reasons of attrition and shrinkage that I spoke to you about and once these marketing plans come on whenever they decide to launch it, right now we do not have a clear guidance on whether it is going to be in our Q3 or in Q4, but our expectation is that at least for the next 6-months we have a clear plan based on the current volume guidance that we have been given, how to turn around the program into a breakeven basis. I am not even talking profitable, I am talking about breakeven in the care work, but the Web Chat work will be incredibly profitable, so at an account level it will generate reasonable level of profitability and are very decent ROI. It will be margin-percentage dilutive because of the catch-up of the performance turnaround in the Care business but that is being offset by the cost saving initiatives which we have embarked…I gave you a number of Rs.15 crores which starts translating itself from Q2 onwards and picks up momentum in Q3 and Q4 which effectively subsidizes some of the inefficiencies we have seen in this large Telco. That is why while my margin guidance at the EBITDA level is down by 25 basis points, there could be some upward trajectory at this point in time, and I cannot articulate it, because some of the play-outs on the turnaround in the Care business could have positive surprises.

Mohit Jain: On this new left out deal that you are talking about, should we assume that the margins are better than the company average?

Rajesh Subramaniam: The margins are attractive, yes.

Mohit Jain: Or that is to be seen as and when you sign it?

Rajesh Subramaniam: No, the deal principles are all done, the margins are attractive and in any transformation play, the core play of how the margins can expand will be on how quickly we can drive transformation to reduce the number of people for the same level of work and then with that you couple the growth because the business that we are going to be working for is the growing business. So the whole bunch of theories which can emerge once we inherit the business.

Mohit Jain: But from first quarter it will be better than the company average or …?

Rajesh Subramaniam: Absolutely, there is no cost of growth. Inherit I start billing at a certain profile.

Mohit Jain: Is there any balance sheet implication also apart from the $10 million payout?

Rajesh Subramaniam: Nothing else.

Mohit Jain: No debts taken or no…?

Rajesh Subramaniam: Because we have got the cash to do the deal now.

Mohit Jain: No, what I mean to say is no debts taken from that along with the deal?

Rajesh Subramaniam: No, it is part of my customer network.

Moderator: Thank you. The next question is from the line of Rumit Duggar from Religare. Please go ahead.

Rumit Duggar: I had four questions: My question was from a structural perspective. If you see over the last couple of years, you have had some segments of your portfolio doing really well while some of the other segments sort of dragging you down. So from a 2-4-year perspective, how do you want to structure your portfolio from a vertical perspective or from a service line perspective, so that investors can get more earnings predictability, more stable ROE profile? The second question was on the US Telco deal. As I understand you were brought in into that deal as a challenger. So how is your performance been stacking up against some of the existing vendors or are you at the bottom quartile there in the non-Web Chat segment?

Rajesh Subramaniam: On the second question, six new vendors were added and we are in the middle of the pack at this point in time. So, from a champion challenger perspective, as you rightly put, this is on

the non-Web Chat, on the Web Chat we are right at the top. From a crystal ball gazing perspective, over the next 3-years is Healthcare should be 50% of my portfolio, Customer Management would obviously constitute the balance and within Customer Management, roughly 50% would be on Digital and Transaction Processing and 50% on pure contact center. Out of the vertical segregation, as much as Healthcare is 50%, I definitely see a big opportunity in Banking, I definitely see the Banking portfolio increase, but we also have seen as I mentioned a huge Web Chat deal that we have won, which will start looking in from Q4 from one of the largest players in the US coming in, a very profitable offshore business. So the impetus on the offshore growth will start looking up from Q4 onwards. So, in an ideal world, 50% Healthcare, 25% BFSI, 25% T&M would be a good 3-year goal to aspire for. From a portfolio perspective, 50% Transaction Processing and Web Chat and then obviously, we will have collections and the core customer contact constituting the balance.

Rumit Duggar: So, in your existing portfolio, you are saying there is a need for you to churn out some of the drag accounts or the drag segments, would that be required right now?

Rajesh Subramaniam: My only problem, my Domestic business is my unknown; last year it was $44 million, this year I am now currently trending at $40 million and there could be a downward bias on this, this year because I have two-three other contract negotiations coming up in September-October… when I say contract, it is not the MSA as much as certain lines who work within the MSAs which are coming up and due for indexation. So, what makes me nervous on the downside is my Domestic portfolio, but the good thing is we have won deals in the e-commerce side, so the second or third largest ecommerce player is now a customer of us, adoption of international practices, profitable business at the enterprise level. And also, on the Telco, we are trying to focus more on the postpaid side rather than the prepaid which is moving to even lower cost destinations like the rural segments.

Rumit Duggar: But fundamentally, Rajesh, would you want to keep Domestic Telco, CRM in your portfolio?

Rajesh Subramaniam: If it makes me money, yes, I am in the business to make sure that I can make money and at this point in time I do not know whether that business is going through a slow death, either that could be a tipping point where if I have to stay relevant, I might have to create investment opportunities which I have no inclination in the current line of work. So any investments we are making is in the new lines of in e-commerce and looking at any other Mobile VAS opportunities, Mobile VAS, again, the last mile is controlled by the Telco. So it is difficult to try and penetrate that, but on e-commerce we definitely have won a deal which is roughly $3.5 - 4 million at positive margins which will again start translating into profitable revenues in Q3 and Q4. But, do I want to stay in this business? It is a very difficult question given the size of the portfolio, if it is a $5, $10 million portfolio, and if it is losing me money, it was easy, but at this point in time the only thing that we are doing is if the economics of the business does not make sense, I am happy to walk away from it.

Rumit Duggar: I understand you have refinanced your debt. So what was the prior cost of debt and by how much would it come down?

Rajesh Subramaniam: From 6% to 4%.

Moderator: Thank you. The next question is from the line of Jambu Ganesh from Jayjam Ventures. Please go ahead.

Jambu Ganesh: A couple of questions only on Healthcare: First, what is the split between the Payer and Provider segment – is it all about the provider that you currently work with?

Rajesh Subramaniam: No, between the Payer and Provider segment, last year the Provider was roughly 60%, Payer was 40%.

Jambu Ganesh: You are expecting a similar growth pattern between Payer and Provider too?

Rajesh Subramaniam: No, Payer will grow far higher than the Provider segment; so, we expect it will be roughly somewhere 50:50 or 55:45 between Payer and Provider.

Jambu Ganesh: You currently cater only to USA in Healthcare or is it some other country too?

Rajesh Subramaniam: No, only United States of America actually.

Jambu Ganesh: Two more questions: What is the kind of competition that you have been facing in the Healthcare alone?

Rajesh Subramaniam: Competition comes from different segments, for example, in the Payer side, my competition is everybody like Cognizant, like Dell, Mphasis EDS, on the Provider side, my biggest competition is Humana One, Parallon, Conifer, MD On, different segments of the business I have different people icon for the business.

Jambu Ganesh: Do you have a lot of pricing pressure in Healthcare as opposed to maybe BFSI or as opposed to Telecom?

Rajesh Subramaniam: Other way round, in the Payer segment, I have lesser pressure because of the growth in volumes, the pain points are different; in the Provider segment, I do have pricing pressure, I do have scope changes which makes adjustments on my base business. So there is some shrinkage I see because of volume discounts and pricing because what happens is we will be among the top five or seven line items of cost as far as the CFO is concerned. So there is always pressure. With the hospital you max out you cannot grow beyond a certain point because you have to reach a certain level of wallet share. On the BFSI segment, lesser pricing issues, any price reductions are in the back of increased volumes on a like-to-like, there have been fewer instances and any price discounts we have given have more than offset some of

the benefits we get from currency. So, there are some adjustments there but over a longer period of time we keep it margin-neutral after absorbing the wage pressure that we see. Telecom and Media: There is pressure on pricing because that industry is still hurting, be it in the Domestic business or in the International business and it is a very high churn, high intensity, high occupancy business. So, my ability of generating a certain level of non-linearity in margins to revenue growth is least in this segment compared to BFSI and Healthcare.

Jambu Ganesh: Your average contract period in the Healthcare?

Rajesh Subramaniam: I do not have that off my hand, but Ganesh, my IR head will share it with you…

Moderator: Thank you. The last question is from the line of Archit Singhal from Nomura. Please go ahead.

Archit Singhal: My question was regarding the revenue guidance basically. I just wanted to understand, we had a degrowth in constant currency terms of approximately 4% in first quarter and we are talking of 7-8% growth for the full year basically. So, is that including the left out deal?

Rajesh Subramaniam: The 4% constant currency is a year-on-year that you are talking about. From a base of Rs.3, 037 crores, that we ended FY15, we are talking about 7-8% growth.

Archit Singhal: If I was to exclude this left out deal, then how will the guidance change of 7-8%?

Rajesh Subramaniam: If you exclude, you will probably take off about 2%.

Archit Singhal: Similarly, the EBITDA guidance of 70 to 90 basis points increase that also includes the factors in the deal, right?

Rajesh Subramaniam: That is right.

Archit Singhal: So just wanted to understand, how will this change if the deal does not happen?

Rajesh Subramaniam: We will come back to you on the math but we are not going on assumption that this left out deal would not happen, first, actually let me qualify given where we are on this deal, the points of failure is practically zero.

Archit Singhal: Just on the US Telco thing, you said $13 million to $15 million can be the loss on the revenue front for the full year?

Rajesh Subramaniam: That is right.

Archit Singhal: You mentioned for the first quarter it was around Rs.12 crores. So that would be around $2 million. So, is it fair to assume that we are assuming that in the next coming quarters, it will increase the revenue impact?

Rajesh Subramaniam: The ramp of that business is scale wise. So what is going to happen is what would have been $23-24 million in the Customer Care will end up closer to being $10-11 million.

Archit Singhal: What would be the impact on profitability for the same?

Rajesh Subramaniam: Profitability this year we are likely to lose about $2.5 million because of this thing.

Archit Singhal: On the total employees which have seen a reduction, particularly in India, what percentage of this relates to offshore business?

Rajesh Subramaniam: No, these are all Domestic business.

Moderator: Thank you. As there are no further questions from the participants, I now hand the conference over to Mr. Rajesh Subramaniam – Managing Director and CEO for closing comments. Over to you, sir.

Rajesh Subramaniam: Thanks for your time today. Has been a little bit of challenge in the quarter because of some expectations on some of the constituents we spoke about not playing out, but in our business some of the speed bumps do occur… sometimes it catches you by surprise, but secularly, I think the environment is looking positive and I think some of our deal wins is testimonial that our transformation offerings be it in Healthcare or in Customer Management is actually wearing itself out and Q2FY16 will be the breakout quarter from a revenue growth perspective and I am cognizant that we will have to grow at 9% between the three quarters to get to our guidance of that we have articulated out. And at this point in time without any further stress on the Domestic business is something we should be able to achieve. So, with those closing comments, I sincerely thank you for your time and happy to meet with all of you individually or in a group depending on any follow-up questions that you may have.

Moderator: Thank you very much, sir. On behalf of Firstsource Solutions, that concludes this conference call. Thank you for joining us. You may now disconnect your lines.